NCAER Podcasts: Episode – 3 (Part-1)

Topic: The Changing Landscape of Dollar Dominance: A Pivotal Discussion

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Transcript:

UD: Namaste and welcome to a new episode of the NCAER podcast series. I'm your host, Udaibir Das, and thank you for joining us on this journey of knowledge and learning, where we aim to demystify a complex topic through an engaging conversation in thought-provoking scenarios. We try to make them directly relevant to economic policy interests in global macroeconomics and finance. We also try to see how those issues may be affecting emerging markets and the Global South more broadly. This two-part podcast will explore a critical aspect of the international monetary system and its relevance for today's world.

As some of you know, this year we are celebrating the 80th anniversary of the 1944 Bretton Woods Agreement, which was a landmark event in modern economic history. Once this agreement was implemented, its provisions called for the US dollar to be pegged to the value of gold, and all other currencies in the system were pegged to the US dollar's value. This agreement, orchestrated by English economist and civil servant John Maynard Keynes, led to the creation of the International Monetary Fund and the World Bank. It also laid the groundwork for integrating emerging economies into the global investment and payments landscape. Now, Keynes was a unique figure. He tried to make his ideas accessible to the public. Of course, there were no podcasts or social media platforms then, but a move that initially cost him credibility among his peers, ultimately established him as an influential public intellectual.

The Bretton Woods system collapsed in the 1970s and countries were then free to choose any exchange arrangement for their currency except pegging its value to the price of gold. However, the 1944 agreement had a lasting influence on the international currency exchange and trade that continues today. The international monetary system, which Keynes helped build 80 years back, is today a hot topic among economists, academics, and policymakers.

UD: Barry Eichengreen will join me today. Barry is a distinguished economist and economics and political science professor at the University of California, Berkeley. He's also a visiting distinguished professor of NCAER. A hearty welcome, Barry.

Barry: Good to be with you.

UD: Now in this podcast, we will examine one aspect of the international monetary system that is under intense public scrutiny, and at times at the forefront of scrutiny by markets, corporations, governments, central banks, academia, and others. The supremacy of the US dollar, or its dominance as it is called, is it changing? And if so, how and in what direction? The future of the US dollar has huge implications for past growing emerging markets like India and developing markets more broadly.

Barry, I must say that some of the discussions going on confound me. I mean, there are headlines such as, BRICS nations take on the US dollar, the demise of the dollar dominance, the impending decline of the US dollar, how to manipulate the dollar. And of course, the more recent one is, can we make America great again by making the US dollar weak again? But I suppose financial statecraft has become, these days, a crucial economic and geopolitical instrument, and the US dollar has become a weapon. And some argue that its status as a global reserve currency is rapidly eroding. And then there are others who believe that it remains the unrivalled dominant currency with no competition. So, let's open with this one, Barry, as brief as you can be. I mean, this appears to be somewhat of a binary construct. So, which side are you? And is it really that simple? Any reactions?

Barry: Economists like to simplify. Historians tend to complicate. I'm an economic historian, so I... complicate but not too much in answer to your question. Therefore, I would say that the role of the dollar globally is eroding but very very slowly because of the advantages of incumbency and because of the absence of viable alternatives.

UD: I see Barry, we'll come back... We'll explore this a little later in the podcast. But I think I wanted to explore who Barry Eichengreen is so that our listeners can get to know you a bit better. Your writings are pretty well known. But on a very personal level, I first encountered your writings back in the 1980s. I was a young central banker then and... somebody I think you know, the late economist Stanley Fischer. He was visiting India in the 80s. And during a conversation on global monetary system and its future, he asked me to check out what I think is your first published paper--Sterling in Decline: The Devaluations of 1931, 1949, and 1967. Now, why I bring that up, Barry, that you have been at it for almost four decades. So, what has made you study the global monetary system for decades? And in those decades, have there been any pivotal moments that led you to focus on the US dollar and its international role?

Barry: Let me start with a small correction and then I'll circle back to your question. Sterling in Decline was my first book, published in 1983 together with Sir Alec Cairncross who was a professor at Oxford back in the day, a student of John Maynard Keynes and a long time British civil servant. So I was lucky enough to have a fellowship, a postdoc at Oxford before I began as an assistant professor and Sir Alec, who was then in his 70s and riding his bicycle to the office every day, said-'You're interested in the 1931 devaluation of Stirling. I lived through, as a civil servant, the 1949 and 1967 devaluations. We should write a book.'

So, that's where that book, Stirling in Decline, came from. Interest in the 1931 devaluation of sterling and the international monetary system was in part strategic. I was interested in international macroeconomics and economic history and this was a way of bringing those two interests together, displaying that I knew how to do modern open economy, macro and economic history as well. I should emphasize that this was not something that was much done at the time. US-based economists, with the exception of a few of you at the IMF, didn't really do open economy macro at the time. And almost nobody did the combination of open economy, macro and economic history. Charlie Kindleberger, who was not my teacher or a colleague, but who I admired greatly, was an exception. But there were very few others one could point to. So, it was also nice to be able to do something new and different.

UD: Well Barry, I think at a very personal level, I must thank you because you had the foresight back then to be able to find where the gap was of something that has become so critical over decades. And now, we are where we are. But there's one sort of related question, Barry, that in these four decades, I have been sort of watching and reading almost everything that you have been putting out. And it has been fast-paced, and if I may say, high quality and highly impactful. And you also do a lot of book reviews almost on an ongoing basis. So, what is the secret? What drives you to sort of remain so fast-paced in your publications?

Barry: Well, partly writing is an artistic experience for me. When I was younger, I played music. I never painted or had that kind of artistic outlet. But for me, writing a clear and hopefully elegant paragraph or essay is an artistic task. So, I enjoy that. And I really only feel fulfilled if at some point in the day I'm able to sit at the computer and do a little writing. It's a long-winded way of saying I enjoy it.

UD: Lovely, lovely. And I hope that is well noted by listeners that Barry Eichengreen loves to write. Okay, Barry, having said all that, let's get on and come closer to the U.S. dollar or the greenback. I think I call it the conductor of the world's economic symphony that sort of sets the tempo for other instruments, other currencies, and is the lifeblood of global commerce and interest. So, can you give our listeners a brief overview of how the dollar became this conductor, the lifeblood? You know, why and how is it that central bankers treat it as a preferred reserve currency of choice? And have there been any events or policies or international agreements that have sort of reinforced the dominance over years? And lastly, have emerging and developing countries played any role in establishing the dominance of dollar?

Barry: In calling the dollar the conductor of the international symphony, you are kind of echoing John Maynard Keynes, who I mentioned before, who called the pound sterling, especially before World War I, the conductor of the international orchestra. Something that was resented by many people in the United States because the dollar played no international role before 1914.

One reason for creating the Federal Reserve System in 1914 was to backstop a market in dollar trade credits and give the dollar more of an international role. So that was step one, I think, in the dollar's emergence as a global currency. Step two was the Bretton Woods Conference in 1944, which mandated that other countries should peg their currencies either to gold or to the US dollar, giving it a unique position in the international system. By 1944, the dollar had emerged as the dominant international currency because only the United States had deep and liquid financial markets open to the rest of the world, because the US was the largest economy in terms of GDP, because the US was the leading exporter immediately after World War II as well.

The next historic event was when the dollar's convertibility into gold at a fixed price was abandoned. President Nixon in 1971 and many people predicted that the dollar's dominance would disappear along with the disappearance of gold convertibility. So, it was something of a surprise that this did not happen and that the dollar became even more dominant in the 1970s, 80s and 90s than it had been previously. Again, I think because of the development of US financial markets, because of the advantages of incumbency, because of the absence of viable alternatives. And after that, it's hard to point to other historic events. There have been attempts by other economies to create alternatives to the dollar, like the creation of the euro in 1999, which really has not supplanted the dollar. Now China's efforts to elevate its currency into an alternative, which is proceeding, but very, very slowly. So, I think I would point to 1914 and 1944 as the principal events and 1971 as a surprising non-event.

UD: And any reaction on my question on how sort of in this play of the decades, I mean, what has been the ro le, if at all, in the emerging markets and developing countries? I mean, have they been basically takers or whatever is happening with dollar and the major currencies or?

Barry: No. As you well know, emerging markets were present at the Bretton Woods Conference in 1944. India was present. There was a recent book by Professor Helliner in Toronto about the role of emerging markets at the Bretton Woods Conference. So, they did influence the shape of the agreement that led to the creation of the IMF and World Bank. There were efforts starting in the 1970s by emerging markets to create alternative groupings, a group of seven, and try to influence international monetary reform. I think the system of swap lines that we have seen, the modest reforms of lending windows and quotas at the International Monetary Fund, all of that has been influenced by emerging markets. So, the US retains the loudest voice. Some of us would argue that the fact that only the US has a veto over significant changes in policies in the IMF is an outdated arrangement but emerging markets have always been at the table.

UD: Excellent. I mean that's a very insightful historical overview Barry and I think our audience must understand the roots of this issue and how these past events perhaps have shaped where we are today. But I'm sure that they're all curious about how these historical events may influence the outlook for the dollar. And we'll come to that later. As you were talking through the decades, several of what I call the 'DE' terms have emerged in policy discussions and market chatter: de-risking, de-coupling, de-globalization, de-leveraging, de-regulation, and then, of course, we have de-dollarization. Any thoughts on how the de-dollarization fits in this trend of the De's, and is there any sort of interrelationships between them?

Barry: So, decline of the dollar as an international and reserve currency has been proceeding very gradually over time. If you look back 25 years, the dollar accounted for about 70% of the international reserves of central banks and governments. Today, it accounts for a little less than 60%. So, this has been a very gradual ongoing trend spanning the last quarter of a century. In contrast, de-risking, de-coupling, de-globalization are recent events, I think, since 2015 or so, accelerating recently with the rise of tensions between China and the West. So, the routes and timing are different between de-dollarization on the one hand and decoupling, de-globalization on the other hand, even de-leveraging, which is a post-global financial crisis ... So, I think **de-dollarization reflects the fact that we are gradually moving toward a more multipolar global economy, less dominated by the United States, compared to the economy we had a quarter of a century ago or in 1944**. On the other hand, de-risking decoupling and de-globalization reflect the realization created by COVID that just-in-time production has risks and the rise of tensions between the US and China, which similarly is a relatively recent event.

UD: That's very interesting, Barry, because I also see how that sort of a construct and the interconnections, but then sort of in a sequence, is perhaps the right way to look at how all these 'De's' are influencing the global economic landscape. But are there any countries, as you sort of look around and study their policies and their international strategies, who are actively pursuing de-dollarization as a strategy? And if so, then why? And if there are countries, Barry, just to complete, I mean, do you think that, I'll be curious, I mean, any potential implications that you think will happen as a consequence of the persistence of this strategy on international balance of payments?

Barry: Overall, there is a lot of chatter about de-dollarization and not a lot of actual movement. But there are two important cases to look at, national cases that I think are indicative of what might happen. The first one is Russia, which has moved away from using and holding the dollar and actively holds more of its reserves now in gold on the one hand and Chinese renminbi on the other hand. So, countries that fear they might be subject to sanctions in US geostrategic crosshairs in the future will be moving away from over reliance on the dollar.

The other case is China, which has been actively trying to promote international use of its currency by developing the relevant infrastructure, by developing a cross-border interbank payments system as an alternative to SWIFT, the messaging system based in Brussels, and as an alternative to the New York clearing house where interbank claims in dollars are cleared. China is making very slow but steady progress in that direction. So, it shows how other countries can develop, if you will, an alternative system of pipes, alternative plumbing to do cross-border transactions in their own currencies as opposed to the dollar.

Then there is a counter-example that you'll be familiar with where India and Russia discussed the possibility of doing bilateral settlements in their respective currencies. And that didn't really take off because the plumbing did not exist. And for Indian policymakers, holding Russian rubles wasn't very attractive, what to do with them. And similarly, for Russia, holding Indian rupee, they questioned how widely that currency could be used in transactions with third countries. That indicates the limits that other countries face.

UD:

Right. And I suppose these two country cases you mentioned, but I mean, there is this, it's an open question', I suppose, whether this will become a trend over time. And then how does it reconfigure the whole you know, currency markets and the role the dollar plays today. But going back on, I want to sort of go back on the dominance question. And there are several theories or factors that have come about to explain the dominance issue in the global economy. I mean, there was this exorbitant privilege theory, the network externalities theory, the safe haven theory, the petrodollar theory. And in a sense, these are perhaps just the way that you laid out over, you know, as putting on your hat as an economic historian as to how these things have gone over decades. But I suppose the issue is more complex and multifaceted than just these four theories, and it is still evolving. But I wanted to ask you that as you have watched this over the four decades, I mean, which of these four would you assume has been of greater or less significance in the centrality of the US dollar?

Barry: I tend to start with network externalities and the dollar's role as a safe haven. And then I move on to qualify those two points of view or question them a little bit. So, network externalities are important. It pays to hold and use the dollar because so many other people in so many other countries also hold and use the dollar. That's the network externalities story. But I think with modern digital financial technology, this network externalities story becomes less compelling. Historically, the dollar has been on one side of 80 percent of global foreign exchange transactions and it's hard to trade Indian rupee for Chinese renminbi without going through the dollar, without selling rupee and buying dollars and then selling dollars and buying Chinese renminbi. Modern digital technology creates alternative platforms where you can go directly from one to the other. And that weakens the hold of network externalities.

So, I think we will see that mechanism becoming less powerful over time because of technology and the safe haven theory where the dollar is a safe asset whenever something bad happens, like Lehman Brothers fails ... People rushed into the dollar nonetheless, because it was viewed as safe and liquid, the US treasury market being the deepest and most liquid market in the world. People are raising questions about the liquidity and stability of that treasury market. And politics may raise questions about whether you want to hold all your reserves, your safe assets in dollars going forward as well. So, whether the dollar will remain a safe haven, I don't think can be taken for granted. The US will have to work to preserve its currency.

UD: So, that sort of ties into what I wanted to ask you next, Barry, Let me take you to a recent speech by Geeta Gopinath, who's the first deputy managing director of the International Monetary Fund. And in that speech, I think this was early this year, Geeta acknowledges that the dollar's dominance could diminish over an extended horizon due to geopolitical shifts, revaluation of trading partners based on economic and national security concerns. And she warns, which is where I want to take this discussion that trade fragmentation into geopolitically aligned blocks and the slow creep away from the dollar as the world's leading reserve currency, in her view, poses enormous risks for future global economic growth. And she made another interesting point. Let me quote from her speech. I quote- ‘FX reserves could be realigned to reflect new economic links and geopolitical risks. A global system with multiple reserve currencies could have benefits, including a larger pool of safe assets and more opportunities for FX reserve diversification. The stability of such a system could be at risk without solid policy coordination among all reserve currency issuing countries, including through the network of swap lines’, something that you mentioned, Barry. And she concludes that this would not be possible if the world were divided along geopolitical lines. So, there are two issues Geetha raises. Barry, is she right on both of them?

Barry: I agree with both of Gita's conclusions, but my starting point would be different. I think we are moving toward a more multipolar or diversified international monetary and reserve system, not because of trade fragmentation only, but more generally because we're moving into a more multipolar world where the weight of the United States and the global economy, even if there is no further trade fragmentation, will be less. Emerging markets will continue to emerge. The weight of India and the global economy will increase relative to the weight of the United States. And one can say the same thing about emerging markets more generally.

So, the fact that the international monetary system will become less dominated by the dollar is not simply a function of trade fragmentation, but a function of the fact that we're moving toward a more multipolar global economy. Is that a good or a bad thing? I would say it was a bad thing in the 1920s and thirties when both the dollar and pound sterling played global roles, but international monetary cooperation collapsed in the Great Depression. You could get sudden destabilizing shifts between the alternative reserve currencies.

Before 1913, on the other hand, the pound, French franc and German Mark all played consequential international roles. But that system was relatively stable because the policies of the principles of the issuing governments were relatively stable. And there was cooperation between the leading central banks. So there again, I would say it's not merely a matter of whether there's a network of swap lines and whether those swap lines span China and the West, but more broadly, whether there are sound and stable policies on the part of the reserve currency-issuing governments and central banks and whether they cooperate with one another.

UD: So, let's link this up with one of your recent writings. You wrote a very compelling blog with my former IMF colleague, Sarkhan Arsenault, discussing the decline in the dollar's share of global foreign exchange reserves. These are reserves which are kept by central banks. And in the blog, Barry, you note that central banks are diversifying into, if I may use the word, non-traditional reserve currencies- Aussie dollar, Canadian dollar. And of course, as you have mentioned earlier, some of them are moving like Russia, holding more of the reserves in Chinese renminbi. And in that blog, you conclude that while, as you have also said earlier in this podcast, the dollar remains dominant, this shift reflects broader changes in the economic landscape, including geopolitical risks. So, I was wondering if you can elaborate a little bit more on this than you already have in the podcast. And what exactly did you have underpinning this blog?

Barry: Let me start with a shout out to our third co-author, Chima Simpson Bell, who collaborated with Sirkin and I on a couple of research papers since published in the Journal of International Economics. In my 2011 book, Exorbitant Privilege, I predicted, not entirely accurately, that the dollar's dominance would slowly but surely give way to the currencies of the other large economies, namely the Euro area and China. But what we've seen in addition is a rise in the reserve currency role of the currencies of other small, open, well-managed economies like Australia, New Zealand, Norway, South Korea, Sweden, et cetera. Their financial markets have grown more open and more liquid. So the fact that these currencies were offering positive interest rates in a decade when the dollar, euro and Japanese yen were not (they all had zero near zero interest rates for a long time), made it attractive for central bank reserve managers to look elsewhere and that's what we have, to my surprise, seen over the last decade.

Now, however, the question becomes whether those currencies can be actively used in payments without going through the dollar, as we talked about earlier. And the answer is not so far, but now we see wholesale central bank digital currencies, that in principle can be traded directly for one another on dedicated platforms, called in bridges or multiple central bank digital currency bridges of the sort that the Bank for International Settlements in collaboration with national central banks is experimenting with. I think we may see more movement in that direction. So, the advantages of scale are less in a high-tech digital world, I think, than they were in the past. And the rise of these currencies of small, open, well-managed economies may be faster. So, this is something for Indian policymakers to reflect on. When I was asked after the dollar and the Chinese renminbi and euro, who's next? Once upon a time, my answer might have been India, South Africa and Brazil. But the advantages of scale as opposed to open markets and liquid financial markets may be less in future than in the past.

UD: I suppose this might even have some implications for the future composition of the SDR. And I was wondering that you have said a lot. I've asked you much. Anything that you feel you want to end this podcast with?

Barry: I would end with the first rule of forecasting, which is give them a forecast or give them a date, but never give them both. The dollar will become less dominant over time. We just can't say how fast or when.

UD: That concludes the first part of my discussion with Barry Eichengreen, where we decoded the US dollar's dominance in the international monetary system.

Please join us for Part 2, which will follow, where we will explore the US authorities' stance on the dollar's international role and its implications for rapidly growing economies like India. As always, we greatly value and encourage your feedback and engagement. So please feel free to tell us your thoughts and ask us questions. You can mail them at info at ncaer.org and we'll try our best to respond promptly. In fact, if need be, I'd be delighted to chat with you. So until then, goodbye, namaste, and remember, while it is what it is in economic policy, it can always be different.